

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52264; File No. SR-BSE-2005-37)

August 15, 2005

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to its Boston Options Exchange Trading Rules Regarding the Extension of a Pilot Program that Increases the Standard Position and Exercise Limits for Certain Options Traded

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 11, 2005, the Boston Stock Exchange, Inc. (“BSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by BSE. The Exchange has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders it effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The BSE proposes to amend the rules of the Boston Options Exchange (“BOX”), an options trading facility of the BSE, to extend its current pilot program to increase the standard position and exercise limits for equity option contracts and options on the Nasdaq-100 Index Tracking Stock (“QQQQ”) (“Pilot Program”) for another six months, from September 4, 2005 to March 3, 2006.

The text of the proposed rule change is available on the BSE’s Web site

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

(<http://www.bostonstock.com>), at the BSE's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the BSE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to extend the Pilot Program, which includes changes to Section 7 (Position Limits) and Section 9 (Exercise Limits) of Chapter III of the BOX Rules. Section 7 of Chapter III of the BOX Rules subjects equity options to one of five different position limits depending on the trading volume and outstanding shares of the underlying security. Section 9 of Chapter III of the BOX Rules establishes exercise limits for the corresponding options at the same levels as the corresponding security's position limits. On March 3, 2005, the Exchange issued notice of the proposed rule change establishing the Pilot Program, which was effective upon filing with the Commission.⁵

⁵ See Securities Exchange Act Release No. 51317 (March 3, 2005), 70 FR 12254 (March 11, 2005) (notice and immediate effectiveness of File No. SR-BSE-2005-10).

Standard Position and Exercise Limits

The Exchange proposes to extend for BOX the Pilot Program for a period of six months during which the standard position and exercise limits for options on the QQQQ and for equity option classes traded on BOX would be increased to the following levels:

Current Equity Option Contract Limit⁶	Pilot Program Equity Option Contract Limit
13,500 contracts	25,000 contracts
22,500 contracts	50,000 contracts
31,500 contracts	75,000 contracts
60,000 contracts	200,000 contracts
75,000 contracts	250,000 contracts
Current QQQQ Option Contract Limit	Pilot Program QQQQ Option Contract Limit
300,000 contracts	900,000 contracts

BOX's standard position limits have been in effect since BOX commenced trading in February 2004. These standard position limits are the same as the standard position limits at the other options exchanges at that time, which were last increased on December 31, 1998.⁷ Since that time, there has been a steady increase in the number of accounts on the options exchanges that: (a) approach the position limit; (b) exceed the position limit; and (c) are granted an exemption to the standard limit. Several member firms have petitioned the options exchanges to either eliminate position limits, or in lieu of total elimination, increase the current levels and expand the available hedge exemptions. Currently all of the options exchanges are operating

⁶ Except when the Pilot Program is in effect.

⁷ See Securities Exchange Act Release No. 40875 (December 31, 1998), 64 FR 1842 (January 12, 1999) (SR-CBOE-98-25) (approval of increase in position limits and exercise limits).

under a similar pilot program which increases the standard position and exercise limits for options on the QQQQ and for equity option classes. A review of available data indicates that the majority of accounts that maintain sizable positions are in those option classes subject to the 60,000 and 75,000 tier limits. There also has been an increase in the number of accounts that maintain sizable positions in the lower three tiers. In addition, overall volume in the options market has consistently increased over the past five years. The Exchange believes that the increase in options volume and lack of evidence of market manipulation occurrences during that same period justifies the proposed increases in the position and exercise limits.

Manipulation

The Exchange believes that position and exercise limits, at their current levels, no longer serve their stated purpose. The Commission has previously stated that:

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations and for corners or squeezes of the underlying market. In addition such limits serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.⁸

⁸ See Securities Exchange Act Release No. 39489 (December 24, 1997), 63 FR 276 (January 5, 1998) (SR-CBOE-97-11) (approval of increase in position limits and exercise limits for OEX index options).

The Exchange believes that the existing surveillance procedures and reporting requirements at BOX and other options exchanges and at the several clearing firms are capable of properly identifying unusual and/or illegal trading activity. In addition, the Exchange states that when the Commission reviewed BOX's regulatory program before allowing BOX to begin trading, the Commission did not uncover any material inconsistencies or shortcomings in the manner in which BOX Regulation's market surveillance of BOX would be conducted. These procedures utilize daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both options and in underlying stocks.

Furthermore, large stock holdings must be disclosed to the Commission by way of Schedules 13D or 13G.⁹ Options positions are part of any reportable positions and, thus, cannot be legally hidden. In addition, Section 10 of Chapter III of the BOX Rules, which requires members to file reports with the Exchange for any customer or member who held aggregate long or short positions of 200 or more option contracts of any single class for the previous day, will remain unchanged and will continue to serve as an important part of the Exchange's surveillance efforts.

The Exchange believes that restrictive equity position limits prevent large customers, such as mutual funds and pension funds, from using options to gain meaningful exposure to individual stocks. This can result in lost liquidity in both the options market and the stock market. In addition, the Exchange has found that restrictive limits and narrow hedge exemption relief restrict member firms from adequately facilitating customer order flow and offsetting the risks of such facilitations in the listed options market. The fact that position limits are calculated on a gross rather than a delta basis also is an impediment.

⁹ 17 CFR 240.13d-1.

Financial Requirements

The Exchange believes that the current financial requirements imposed by the Exchange and by the Commission adequately address concerns that a member or its customer may try to maintain an inordinately large unhedged position in an equity option. Current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer. Also, the Commission's net capital rule, Rule 15c3-1 under the Act,¹⁰ imposes a capital charge on members to the extent of any margin deficiency resulting from the higher margin requirement.

Finally, equity position limits have been gradually expanded from 1,000 contracts in 1973 to the current level of 75,000 contracts for options on the largest and most active underlying securities. To date, the Exchange believes that there have been no adverse affects on the market as a result of these past increases in the limits for equity option contracts.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,¹¹ in general, and furthers the objective of Section 6(b)(5) of the Act,¹² in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition.

¹⁰ 17 CFR 240.15c3-1.

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange has neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the forgoing rule change does not: (1) significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹³ and Rule 19b-4(f)(6) thereunder.¹⁴

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.¹⁵ However, Rule 19b-4(f)(6)(iii)¹⁶ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the five-day pre-filing notice requirement and the 30-day pre-operative delay. The Commission is exercising its authority to waive the five-day pre-filing requirement and believes that waiver of the 30-day pre-operative delay is consistent with the protection of investors and in the public interest. Waiving the five-day pre-filing requirement and 30-day pre-operative delay will allow the Pilot Program to continue uninterrupted.¹⁷

¹³ 15 U.S.C. 78s(b)(3)(A).

¹⁴ 17 CFR 240.19b-4(f)(6).

¹⁵ 17 CFR 240.19b-4(f)(6)(iii).

¹⁶ Id.

¹⁷ For the purposes only of waiving the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR- BSE-2005-37 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File No. SR-BSE-2005-37. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and

copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the BSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-BSE-2005-37 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁸

Margaret H. McFarland
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).